

June 20, 1991

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

POTENTIAL CONFLICT OF INTEREST ARISING FROM PROPOSED
MANAGEMENT AUDIT OF SAN DIEGO DATA PROCESSING CORPORATION

At the budget hearing on June 13, 1991, the City Council asked the City Attorney whether any member of the City Council was prohibited from discussing or voting on a proposed management audit of San Diego Data Processing Corporation ("SDDPC"), because of a potential conflict of interest. This report is in response to that request.

BACKGROUND

By way of background we note that SDDPC is a nonprofit, public benefit corporation organized under California Corporations Code section 5110 et seq. SDDPC is wholly owned by the City of San Diego, which is the corporation's sole member. Although it may enter contracts with other entities, and receive monies for so doing, SDDPC is subject to the City Council's budgetary control. The City also appoints the Board of Directors of the corporation. Under the terms of an operating agreement between SDDPC and the City, SDDPC is the sole supplier for data processing and telecommunication services and equipment to the City.

During Council hearings on proposed FY 91-92 departmental budgets, on June 13, 1991, a question arose about SDDPC's ability to meet the City's future data processing needs. Councilmember Roberts proposed an "outside" management audit by the City Manager of SDDPC's operations. It remains unclear at this writing who will accomplish the audit. A Request for Proposal is still being prepared. Hence, it is prudent that we examine the conflict issue from the perspective of both an audit conducted by City forces and one conducted by an outside consultant.

For purposes of this report, we examined the Statements of Economic Interest ("SEI") of the Mayor and each Councilmember covering calendar year 1990, the most recent SEI's on file for Councilmembers. We also obtained information from representatives of the Department of Financial Management and from SDDPC, including their legal counsel Larry Marshall.

QUESTIONS PRESENTED

We understand the City Council had the following two (2) legal questions about their ability to require a management audit of SDDPC:

1. May the City require a management audit of one of its wholly owned nonprofit, public benefit corporations, SDDPC, without unlawfully interfering in the management of the corporation's affairs?

2. Does the Mayor or any individual Councilmember have a conflict of interest in participating in discussions or voting on whether to require a management audit of SDDPC?

ANALYSIS

Question No. 1: The Council wishes to know whether they may require a management audit of one of the City's wholly owned nonprofit public benefit corporations, SDDPC, without unlawfully interfering with the management of the corporation.

SDDPC was formed in 1979 under California's Nonprofit Public Benefit Corporations Law. California Corporations Code section 5110 et seq. The relationship between the City and SDDPC is governed by an Operating Agreement adopted in 1979 (City Clerk's Document No. RR-250208). The agreement has been amended several times since it was first executed, but not for reasons pertinent to this discussion.

Article 10 of the Operating Agreement clearly permits a "management audit" of SDDPC. This article reads as follows:

10. AUDIT AND REPORTING PROCEDURES.

Corporation agrees to allow City officials complete access to all personnel, operational and financial records and data pertaining to the services provided pursuant to this agreement. Corporation further agrees to submit to City in the form requested by the City Council or City Manager any reports deemed necessary by City in connection with the services to be provided pursuant to this agreement.

The language is explicit: the City has access to all of SDDPC's "personnel, operational and financial records" pertaining to services provided under the agreement. Therefore, we conclude that the Council may lawfully require a management audit of SDDPC.

By way of information only, while conducting our research, we found that SDDPC on its own motion has engaged a private consultant to examine management and communications issues within the corporation. SDDPC through its counsel Larry Marshall informs us that the corporation stands ready to present the results of the management study to the Council at any time the Council so desires.

Question No. 2: The Mayor and Councilmembers wish to know whether they are prohibited under the Political Reform Act from requiring a "management audit" of SDDPC.

The Political Reform Act (California Government Code section 81000 et seq.) prohibits participation in a governmental decision in which the public official knows or has reason to know he or she has a financial interest. The phrase "financial interest" is statutorily defined. California Government Code sections 87100; 87103.

The Fair Political Practices Commission ("FPPC"), who administers the

Political Reform Act, has formulated a four (4) part test for disqualification:

Under the foregoing sections, several elements must be present before a public official is required to disqualify himself from participation in a governmental decision. First, it must be reasonably foreseeable that the governmental decision will have a financial effect. Second, the anticipated financial effect must be on a financial interest of the official, as defined in Sections 87103(a) through (d). Third, the anticipated financial effect must be material. And fourth, the governmental decision's anticipated financial effect on the official's financial interest must be distinguishable from its effect on the public generally.

In re Opinion requested by Tom Thorner, 1 FPPC Opinions, 198; 202 (December 4, 1975).

Assuming the Council chooses to have the audit conducted by City forces, we find there will be no financial effect on the Mayor or Council resulting from the decision to conduct an audit using City forces, simply because there is no "financial interest" in the entity (the City) conducting the audit.F

The City's salary to the Councilmembers does not qualify as "income" for purposes of the Political Reform Act (Government Code section 82030(b)(2)).

We contrast this with our June 5, 1989, Memorandum of Law in which we found that certain members of the Council were disqualified from making a decision pertaining to SDDPC because they had investment or income interests in firms that proposed to contract with SDDPC.

In addition to determining that the Mayor and Councilmembers have no financial interest in the entity conducting the audit (the City), we find that the Mayor and Councilmembers have no financial interest in SDDPC itself. According to SDDPC's Articles of Incorporation, as amended on February 24, 1986, (City Document No. R-265148), SDDPC is a nonprofit corporation without capital stock and is a corporation which does not contemplate pecuniary gain to any private person. Also, no part of the net income or assets of this organization is to inure to the benefit of any private person. Furthermore, we find nothing to link SDDPC with the financial portfolios of the Mayor and Council as shown in their SEI's. In short we find no financial interests of the Mayor or Council will be affected by this decision.

Therefore, we conclude that neither the Mayor nor any Councilmember has a financial conflict of interest prohibiting them from participating in discussions or voting on the decision to conduct a management audit of SDDPC.

Should the Council decide to conduct the management audit of SDDPC with an outside consultant, the issue of the Mayor and Council's potential conflict of interest in the decision to select an auditor/vendor will be reexamined in light of facts then known about potential vendors of auditing services. The examination would focus on whether the Mayor or any Councilmember has a financial interest in the competing firms. Absent any such interest, the Mayor and Councilmembers would be free to participate in the selection.

Respectfully submitted,
JOHN W. WITT
City Attorney

TB:CCM:jrl:(043.1)
RC-91-32